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Conflicts of interest in litigation services engagements; Consulting services special report, 93-2

American Institute of Certified Public Accountants. Management Consulting Services Division

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AICPA

**CONSULTING SERVICES
SPECIAL REPORT 93-2**

***Conflicts of Interest
in Litigation
Services Engagements***

AMERICAN

INSTITUTE OF

CERTIFIED

PUBLIC

ACCOUNTANTS

Management Consulting Services Division

NOTICE TO READERS

This special report is designed as educational and reference material for Institute members and others who provide *consulting services* as defined in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA. It does not establish standards or preferred practices.

Various members of the 1991-1992 AICPA Litigation Services Subcommittee provided information for this special report and advised the authors and staff. The subcommittee members are listed below.

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**CONSULTING SERVICES
SPECIAL REPORT 93-2**

Conflicts of Interest in Litigation Services Engagements

AMERICAN

INSTITUTE OF

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ACCOUNTANTS

Management Consulting Services Division

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72/100

**CONFLICTS OF INTEREST IN LITIGATION
SERVICES ENGAGEMENTS****72/105 PROFESSIONAL ISSUES IN LITIGATION
SERVICES**

.01 Litigation services are rendered by a CPA using accounting and consulting skills to assist a client in a matter that involves potential or pending litigation or dispute resolution proceedings with a trier of fact. The services rendered may include fact-finding (including assistance in the discovery and analysis of data), damage calculations, document management, expert testimony, and other professional services. Bankruptcy, reorganization, and insolvency services as provided by CPAs generally are considered litigation services. A CPA providing litigation services will have responsibilities as an objective professional that range from rendering a judgment about accounting principles or facts at issue to providing analyses of and opinions regarding one of several acceptable alternative calculations or determinations (even under generally accepted accounting principles). The CPA's interpretation of conflicts of interest that could result from accepting a litigation services engagement may differ significantly from that of the attorney who owes nearly total allegiance to and is an advocate for the client.

**The Need to Maintain Integrity
and Objectivity**

.02 In a litigation services engagement, a conflict of interest exists when a CPA's ability to objectively evaluate and present an issue for a client will be impaired by current, prior, or possible future relationships with parties to the litigation. As a professional, the CPA should avoid engagements that involve conflicts of interest. Rule 102 of the AICPA Code of Professional Conduct requires that members shall, in the performance of any professional service, maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate their judgment to others.

.03 The criterion for evaluating whether a conflict of interest is involved in a litigation services engagement is the ability of the CPA to maintain integrity and objectivity as described in the Statement of Standards for Consulting Services (SSCS). A conflict of interest is based in fact, rather than appearance. However, the CPA should be mindful of and deal with appearances of conflicts before accepting the engagement.

.04 Interpretation 102.2 of the Code also indicates that a conflict of interest may occur if, while performing a professional service for a client, the CPA or the firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing their objectivity. The rule provides, however, that if this significant relationship is disclosed

to the client and other appropriate parties, and they consent to the CPA's acceptance of the engagement, the rule shall not prohibit the performance of the professional service.

.05 In addition to the rule and related interpretation concerning conflicts of interest, the CPA who provides litigation services must also consider the impact of rule 301, "Confidential Client Information." Rule 301 prohibits a member in public practice from disclosing any confidential client information without the consent of the client. The CPA therefore may be unable to disclose to or obtain consent from all of the appropriate parties. Indeed, the legal process may operate to prevent the CPA from disclosing any information to other parties, particularly in the case of expected or threatened litigation. Rule 301 may restrict the CPA's attempts to resolve apparent conflicts of interest or business relationships. Problems arising under rule 102, its interpretation, and Rule 301 are commonly referred to as conflicts of interest, perceived or otherwise, in the provision of litigation services.

The Concept of Independence

.06 Independence is not a criterion in the determination of whether a conflict of interest exists in a litigation services engagement. Independence as an ethical issue is limited to attestation engagements¹ as required by the attestation standards, which also address the question of the appearance of independence. The independence concept was developed to ensure the CPA's objectivity and credibility in examining and reporting upon financial statements that will be relied upon by people who cannot investigate the assertions. The reliability of the CPA's professional opinion of the financial statements gives them more credibility and usefulness. The independence concept forms an important part of the comprehensive and well-documented set of standards applied to attestation services. However, in generally accepted auditing standards, little guidance is provided on the relationship of the independence concept to litigation services.

Conflict Issues for CPAs

.07 Unlike the legal profession, the accounting profession has developed little formal guidance on conflicts of interest. Most guidance relating to the CPA's professional relationships concerns the concept of independence, focusing primarily on the relationship between the CPA and the client in an attestation engagement. This guidance, however, is not directly concerned with relationships that the CPA may have in other types of engagements.

.08 The increasing use of CPAs as consultants and expert witnesses in litigation has required them to consider their professional relationships in new ways. When an attorney seeks to engage a CPA for litigation services, both professionals are concerned with whether the CPA has a conflict of interest with any of the parties to the litigation. Unfortunately, there is much

¹ See the AICPA MAS Special Report *Comparing Attest and Management Advisory Services: A Guide for the Practitioner*. (New York: AICPA, 1988).

confusion as to precisely what this means. An attorney has a well-defined and documented concept of what constitutes such a conflict in the legal profession. Consequently, this concept may be applied inappropriately to the CPA, who may be confused as well because of the lack of guidance in professional accounting literature. However, the standards of the legal profession concerning conflicts of interest should not be applied to the accounting profession because the roles of the attorney and the CPA in litigation are entirely different.

.09 A conflict of interest may arise from the CPA's ethical obligation to preserve client confidences or from the existence of relationships that may undermine objectivity in presenting an issue concerning a client. In judging conflicts of interest, the CPA should differentiate between those based on fact and those that could arise as a result of perceptions or business considerations. The CPA may come to different conclusions based on the category into which the issue falls. The CPA may base a decision to decline an engagement on the existence of the perception that a conflict exists, on business considerations, or on other reasons such as lack of expertise or time. Conversely, absent a conflict of interest or possession of confidential information, the CPA may accept an engagement even if business relationship issues exist.

.10 The CPA must decide whether a conflict of interest exists on a case by case basis. If none exists, the CPA must then decide whether a business relationship or a perception of a conflict exists that may warrant declining the request for professional services. For example, the CPA may decline to perform services because the position required by the prospective client conflicts with the business interests of an existing client. Thus, while a conflict of interest may not exist as defined by the professional standards, conflicting business relationships may indeed exist. This determination is based on the CPA's judgment. If a perception of conflict exists, the CPA may be unable to obtain permission to accept the engagement from all of the appropriate parties because of confidentiality of information. In this instance, the CPA may have to evaluate whether a conflict of interest actually exists.

.11 Clearly, multi-office CPA firms face a difficult problem in monitoring conflicts of interest. Opportunities for conflicts arise not only because of the number of offices and clients but also because of the variety of services offered by these firms. Multi-office firms may therefore need a formal system to identify relationships that pose potential conflicts of interest.

.12 Before accepting a litigation services engagement, CPAs carefully evaluate their relationships, if any, with all parties to the action to identify potential conflicts. These parties include named and potential adverse parties including counsel to the opposing parties. During the course of an engagement, there is always the potential for a non-opposing party to become an opposing party. Therefore, continuing sensitivity to newly arising conflicts is necessary, particularly in engagements that are long or involve several parties.

.13 In evaluating certain situations, the CPA may conclude there is no conflict but that the attorney could perceive a conflict. Before accepting such an engagement, the CPA should disclose to the retaining attorney any prior or existing relationships with all parties to the litigation, if disclosure is permitted by the parties with whom the CPA has a confidential relationship. When possible, disclosure of such relationships is good practice, even if a conflict may not exist. Great care, however, should be taken to avoid disclosing client confidences, including names, which in themselves may be confidential. Indeed, there may be circumstances

in which the very fact of a prior relationship is confidential. In rejecting an engagement, the CPA may not disclose confidential information gained from another client.

Differences Between CPAs' and Lawyers' Professional Responsibilities

.14 The litigation services practitioner should understand the difference between the responsibilities of accountants and those of attorneys under each profession's conflict of interest rules. An attorney in litigation is an advocate for the client. Indeed, the attorney has an ethical obligation to represent a client "zealously within the bounds of the law." By design, the American litigation process is an adversarial proceeding in which the best case for each litigant is put before the trier of fact. The attorney who is neutral, independent, and objective could not do the job well. As law professors Aronson and Weckstein have put it:

Once a lawyer agrees to serve as an advocate, he must loyally safeguard his client's interest, urge any permissible construction of the law favorable to the client—without regard to his personal opinion as to what construction will ultimately prevail—and, in general, must resolve any doubts as to the law and facts in the client's favor.²

.15 This duty of advocacy is not just a characteristic of the legal profession but is part of its very fabric:

Of equal importance in our adversary system is that counsel be loyal to his client. 'The duty of a lawyer, both to his client and to the legal system, is to represent his client zealously within the bounds of the law...' [EC7-1] Note that this partisanship does not arise merely from any retainer paid by the client to the lawyer, but is imposed upon the lawyer by the legal system, regardless of the presence or absence of financial remuneration. There is no basic conflict between the duty of lawyer to his client and to the court. In the adversary system, loyalty and zealousness in representation of the client is the primary duty of the lawyer as an officer of court.³

.16 The litigation process demands that the attorney take every available advantage for the client, put the client's case in the best possible light, not offer evidence that is harmful to the client (with some exceptions), and challenge everything possible in the opponent's case. The

² Aronson, R.H. and D.T. Weckstein, *Professional Responsibility* (West Publishing Co., 1980), p. 13.

³ *Ibid.*, p. 272.

opposing attorney, of course, has the same job. In a very real sense, a litigating attorney becomes the client's champion.

.17 It is thus not only appropriate, but also absolutely necessary, that lawyers have a strict conflict of interest policy. It generally is not possible to represent one client while also representing another with actual or potentially opposing interests. To attempt to do so, however carefully, would be intrinsically unfair to both clients. For this reason, before accepting an engagement, lawyers go to great lengths to ascertain whether they represent or have represented other clients whose interests do or could oppose those of a prospective client.

.18 The American Bar Association Rules of Professional Conduct contain several rules concerning conflicts of interest. According to the general rule, an attorney shall not represent a client if doing so would be directly adverse to the interests of another client or if the representation of that client may be limited materially by the attorney's responsibility to another client or third person or by the attorney's own interest. In both cases, however, the attorney who reasonably believes that representation will not adversely affect the relationship with the other client, may represent the client if both clients consent after a full disclosure of the circumstances and consultation (with certain stated exceptions). The general rule also provides that the attorney who represents several clients in a single matter must explain to each the implications of the common representation and the advantages and risks involved.

.19 The general rule does not alter the arguments of case law and ethics opinions that, in certain cases involving actual or apparent conflicts, consent to continued representation is immaterial, and in certain cases or situations in which the conflict is apparent rather than real, multiple representation is not permissible. In addition, the rule provides that a lawyer who has represented a client in a matter shall not represent another client in the same or a substantially related matter whose interests are materially adverse to the interests of the former client, unless the attorney fully discloses the circumstances in consultation with the former client.

.20 The legal profession's *Canons of Ethics* provides that loyalty is an essential element in the attorney's relationship with a client. Maintaining the required independence of professional judgment precludes accepting or continuing employment that will adversely affect the attorney's judgment on behalf of or dilute loyalty to a client. The problem often arises when an attorney is asked to represent two or more clients who may have interests that are conflicting, inconsistent, diverse, or otherwise discordant. An attorney is an advocate who owes complete loyalty to the client.

.21 The CPA as an expert witness has a role that differs from that of an attorney. The CPA does not serve as an advocate but rather is presented to the trier of fact as someone with specialized knowledge, training, and experience in a particular area and presents positions with objectivity. The function of the CPA as an expert witness is to assist the trier of fact in understanding complex or unfamiliar concepts. The CPA expert is not expected to singlemindedly and one-sidedly offer only evidence and opinions that help the client. The CPA is expected to offer an objective opinion, based on knowledge and experience, of how the issues at hand should be interpreted by the trier of fact. A CPA is required by professional standards to maintain objectivity and integrity in providing any professional service. Rule 102 of the *Code of Professional Ethics* of the AICPA states:

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

.22 The essential qualities of objectivity in a CPA expert are perhaps obscured by the fact that the role is executed in an adversarial process. The CPA is offered to the court and paid by one side. Nevertheless, the CPA's opinions should be based on the facts in a given case, regardless of who the client is. Indeed, several elements of the litigation process strongly encourage objectivity. First, the CPA expert presents the work and opinions under oath. Secondly, the bases for the CPA expert's opinions usually are subject to comprehensive discovery by opposing attorneys as well as cross-examination at trial. The work may also be subject to rebuttal by similarly qualified experts hired by the opposing side. Furthermore, the CPA expert's long-term credibility is at risk, since testimony might be used in certain circumstances to impeach testimony in subsequent cases.

.23 In effect, the requirement for objectivity and integrity for a CPA cannot readily be equated with the undivided loyalty to a client required of a lawyer. Accordingly, many relationships that would result in a conflict of interest for a lawyer may not result in a conflict for the CPA expert.

.24 The role of the CPA working directly for an attorney may be further complicated because of the privileged nature of communication that may extend to the accountant's work product. The CPA must decide whether there is a conflict of interest or business relationship considering the context of the work requested and the nature of the advice sought. The CPA judges whether the expected role is to function as an objective expert or to support a position taken by counsel. The CPA must maintain objectivity and integrity as well as avoid conflicts of interest and must be careful to avoid a position of advocacy that would lack integrity (for example, supporting a position the CPA knows to be false).

72/110 ILLUSTRATIVE CASE STUDIES

.01 The following case studies illustrate the potential conflicts of interest or business relationships that a CPA may encounter when asked to provide litigation services.

Simultaneous Conflicts

.02 Barbara Smith, a CPA, has worked with clients in the travel industry for several years. Her current engagements include attestation and consulting services for Airline A, a national carrier. The consulting services engagement involves assisting management to evaluate marketing strategies for dealing with competition. Recently, Commuter B, a start-up commuter airline, filed suit against Airline A for causing it economic losses by operating below cost in the market area. Because of Smith's expertise in the airline industry, Commuter B asks her assistance in preparing its claim for damages. Should Smith accept this engagement?

.03 Rule 301 of the AICPA Code of Professional Conduct states: "A member in public practice shall not disclose any confidential client information without the specific consent of the client." Smith therefore should consider whether she has obtained confidential client information in providing Airline A with attestation and consulting services. Since these services probably involved reviewing information relevant to Commuter B's lawsuit, Smith should question whether to accept this engagement because it would appear to compromise Airline A's confidences.

.04 Rule 301 suggests that with Airline A's consent, Smith could pursue the engagement. However, it may be difficult to obtain such consent. Furthermore, as a matter of business practice, most CPAs would not accept an engagement directly adverse to the interests of a continuing attestation client. Such an engagement might cause difficulties for Smith in assessing valuation and disclosure requirements for the financial statements of the attestation client and in maintaining confidentiality for the two clients. Airline A likely would have to be advised adequately of the nature of the Smith's prospective engagement with B in order to make an informed decision. To advise A of this, Smith would require the approval of B's lawyers, who would be concerned about the confidentiality of their trial preparation plans if she were to describe the nature of the engagement adequately.

.05 In a different situation, Alan Mason, a tax CPA, provides Company A with only tax advice and tax compliance reporting. Company B approaches George Carpenter, a partner in the litigation services division of Mason's firm, for assistance in developing its damages case against Company A. The damages case involves matters totally separate from the tax engagement. Should Carpenter decline this engagement because of a potential conflict of interest?

.06 If Carpenter has had no access to confidential information about the matter in litigation and would establish procedures to ensure there will be no such access during the pendency of the case, he could conclude that no conflict exists. However, the existence of the tax engagement should be disclosed to the attorney for Company B and, if possible, Company A also should be informed. Early disclosure gives Company B's attorney an opportunity to consider this issue before retaining Carpenter and gives Company A an opportunity to object if it views the appearance of conflict differently from Carpenter.

.07 Carpenter may also wish to consider the impact of the engagement on his tax partner's relationship with Company A. Although Carpenter may not have a conflict of interest, he may decide to decline the engagement for business considerations. Business interests may cause the CPA to refuse an engagement, but the limited knowledge gained by others in the firm in any specialized area may not create a conflict of interest.

.08 In performing an audit or an attest function for a client, CPAs generally have broad access to confidential information. Therefore, they should be much more sensitive to actual conflicts of interest when they are providing attestation services to one of the litigants involved.

Subsequent Conflicts

.09 CPA Smith's consulting services to Airline A involved only a completed engagement to assist in developing a marketing plan. There is no ongoing relationship. Subsequently, Commuter B approaches Smith for assistance with damages in its lawsuit. Does the lack of an ongoing relationship permit Smith to accept the engagement with B?

.10 Rule 301 on confidential client information is not limited to current clients. A practitioner must be able to have the full confidence of a client in order to provide assistance adequately. To ensure this relationship, the profession assures clients that information gained in an engagement will never be disclosed to others without their consent. Thus, Smith must consider carefully whether the litigation services engagement would create a conflict by appearing to require use of information obtained in the consulting engagement.

Preliminary Interviews With Prospective Clients

.11 When a CPA is approached by a prospective client about a litigation engagement, the client or its attorney typically will give the CPA sufficient information about the case to assist in identifying the opposing parties, the key issues in dispute, and the role intended for the CPA. In describing the matter at hand, the prospective client may communicate confidential information to the CPA. If the CPA is not retained by this prospective client and subsequently is approached by the client's opposition, must the CPA decline the opposition's offer of an engagement to protect the confidential information received previously?

.12 This question has not been specifically addressed by the accounting profession. However, rule 301 prohibits revealing any confidential client information. State bar associations generally have concluded that a prospective client from whom an attorney obtains confidential information during an initial interview is a client nonetheless, against whom the attorney cannot use this information. This conclusion may guide the CPA even though the rules of conflict of interest for attorneys differ from those for accountants. To avoid this problem, the CPA should attempt to limit the confidential or strategic information received before deciding on the prospective engagement.

Joint Representation

.13 Joint representations occur when a CPA is engaged by both opposing parties for assistance in resolving the issues in their dispute. A request for joint representation could arise in a variety of circumstances. Given the adversarial nature of a litigation services engagement, before accepting one, the CPA should carefully consider the nature of the relationship with each of the parties and the role to be played. The concern is usually greater in marital dissolutions as is illustrated in the following case.

.14 Joan Evans, a CPA, has provided a full range of services to a married couple for several years. The husband is a principal in a closely held business for which Evans has provided consulting and accounting services. In addition, the couple has acquired ownership

interest in several pieces of income property for which Evans has provided tax advice as well as accounting services. In a marital dissolution action, the couple requests Evans's help with the accounting and valuation aspects of the property settlement. Can Evans accept this engagement?

.15 A lawyer's ability to represent both parties in a dispute has been restricted by case law and legal ethics because of the lawyer's role as advocate. An accountant, however, brings objectivity to a dispute. Even so, it may be difficult for Evans to advise adequately both parties to a divorce, given their prior relationships. In deciding whether to accept the engagement, Evans needs to consider two issues. First, during her prior engagement with the couple, she may have received confidential information from one of the parties. By accepting the joint engagement, Evans might compromise the confidential nature of these communications. The second issue concerns objectivity. Evans may have a more significant economic relationship with one spouse through work performed for the business. This relationship could lead to an inability to provide objective advice for both spouses.

.16 The nature of the prior relationship must govern the decision. If there was no prior relationship with the couple, or the relationship was limited in scope, Evans could consider accepting the engagement. Nevertheless, in joint representations the adversarial nature of the dispute is an inherent risk. A CPA might be best advised to act as a court-appointed accountant to be insulated from the adversarial nature of the assignment. In any event, there should be complete disclosure to both parties, and the CPA should obtain informed consent to the joint representation with a clear identification of the engagement's scope.

.17 The CPA should consider the same factors before accepting engagements in which two clients with potentially differing interests ask for common assistance. Borrowers and lenders and buyers and sellers may also request joint representation. In general, the CPA would have no conflict and could accept engagements to resolve business disputes between two parties objectively.

Simultaneous Consultations

.18 The issue of a conflict also arises when a CPA is engaged to work simultaneously for and against clients of the same law firm in different cases. For example, Expert A may be retained by Counsel A to assist Plaintiff A by providing a valuation of an apartment building. Counsel B is the attorney for Defendant B in this matter. Before the case goes to trial, Counsel B approaches Expert A about an unrelated case. Counsel B, however, is unaware that Expert A is a consultant for Counsel A in Counsel B's other case. Does Expert A have a conflict in this situation?

.19 Since no confidential client communications are involved, and Expert A can maintain objectivity and integrity, there is no conflict of interest. Nevertheless, the situation is ticklish because Expert A may wish to notify Counsel B of the relationship with Counsel A. However, such notification ethically cannot be given until Counsel A chooses to disclose that Expert A has been retained. Expert A may seek permission from Counsel A to disclose the relationship;

however, lacking approval, Expert A may wish to refuse the engagement offer of Counsel B without disclosing the reason.

.20 This conflict question raises a problem for counsel rather than an ethical question for the expert witness. An attorney may feel that the engagement of the CPA implies approval of the opponent's expert. The CPA should be aware of the potential for problems in such circumstances and should fully disclose such relationships to counsel, if possible, before accepting an engagement.

.21 This situation presents a conflict of business relationships, not a conflict of interest, and thus is a matter for the individual CPA to decide.

Other Potential Conflicts

.22 Several other situations give rise to considerations of conflicts of interest or business relationships. The CPA may be asked to testify on one side of an issue after testifying on the other side in a previous case. This situation can be complicated further in a multi-partner firm, if one partner testifies on one side of an issue and another partner is later asked to testify for the other side. In both cases, conflict of business relationships clearly exist and indeed the appearance of a conflict of interest may exist in the public's perception of the CPA's or the firm's views. Under generally accepted accounting principles, however, alternative views may be possible and indeed permissible. For example, under differing fact patterns, different conclusions may be drawn. A consistent position, however, would benefit the credibility and posture of the CPA. In these situations, the CPA's public image may be a more significant concern than the applicability of any conflict of interest rule.

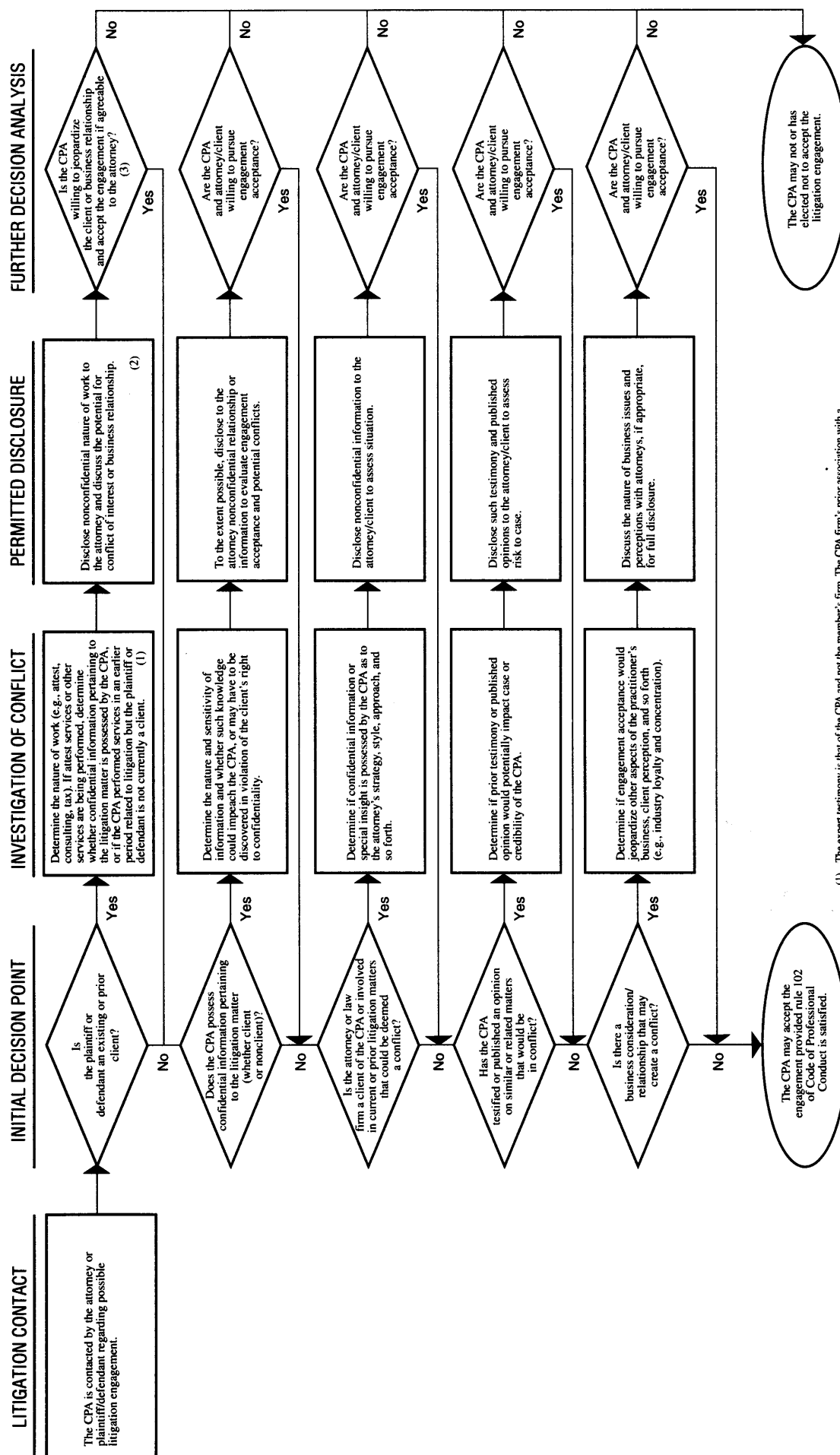
.23 The expert opinion rendered in a court of law is that of the individual not the firm. Thus, differences of opinion among a firm's partners should not automatically discredit the testimony of an expert witness. However, disclosure of the situation to client or counsel is recommended.

.24 Another potential conflict may exist when the CPA is involved in a multi-party case. For example, the CPA's existing client may be a named member of a class or group or may be providing services to large governmental entities. A definition of conflicts associated with large groups would be far too broad a guideline to be effectual. For example, a CPA who assists a client in opposing an Internal Revenue Service ruling while performing services for another government agency at the same time is unlikely to be considered to have a conflict of interest. However, it is conceivable that certain situations involving government agencies may give rise to conflicting business relationships that would, in the CPA's own judgment, preclude helping to oppose one agency while working for another agency.

72/115 SUMMARY

.01 This special report is not intended to cover all situations that may give rise to conflicts of interest or of business relationships. Its purpose is to illustrate the diversity of situations that could give rise to such problems. The nature and complexity of litigation service engagements make it imperative that potential conflicts be identified early, preferably before the CPA accepts the engagement. The CPA should discuss situations that give rise to any questions of conflicts with the client's lawyer to permit evaluation before litigation services are provided.

Conflict of Interest Decision Tree



(1) The expert testimony is that of the CPA and not the member's firm. The CPA firm's prior association with a company would generally not create any attribution of the firm's knowledge to the testifying CPA, so long as the CPA has no direct or indirect knowledge. However, such prior or current association should be disclosed to the attorney provided no sensitive information is shared.

(2) Although a CPA's firm may have a current or prior business relationship with a plaintiff/defendant through providing attest or other services, such relationships would not necessarily create a conflict of interest (provided confidential information is not possessed by the testifying CPA). However, there is likely a business or client relationship that would create a business conflict requiring the CPA to decline the engagement.

(3) Should a CPA decide to pursue litigation opposite an attest client (e.g., fraudulent conveyance litigation involving a bank), the litigation probably should not be material to the financial statements of the attest client.

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